



ACQUISITION

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MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES  
DIRECTOR, CONTRACTING, ASA(RD&A)/SFRD-KP  
DIRECTOR, PROCUREMENT POLICY, ASN(RD&A)/API&A  
DEPUTY ASSISTANT SECRETARY (CONTRACTING), SAF/AQC  
EXECUTIVE DIRECTOR, CONTRACTING, DLA-P  
EXECUTIVE DIRECTOR, CONTRACT MANAGEMENT, DLA-A

SUBJECT: **Payment and Withholding of Funds under Time-and-Materials Contracts**

The Inspector General has recently completed a review of time-and-materials contracts and found some misunderstanding of the payment and withholding provisions of the clause at FAR 52.232-7, Payments under Time-and-Material and Labor-Hour Contracts. These contracts are a form of cost-reimbursement contract. Thus, billings for labor hours must be made by public vouchers and the cognizant Defense Contract Audit Agency auditor must review and approve vouchers. Contracts shall not provide for any other arrangement.

Paragraph (a) (2) of this clause provides the Government the right to withhold 5 percent of payment <sup>8</sup> otherwise due, up to a maximum of \$50,000. The Inspector General found a widespread lack of understanding of the purpose of the withholding and the applicability of the \$50,000 ceiling on withholdings, as well as confusion on when the amount of withholding should be revised.

The contract clause directly links the 5 percent withholding to delivery of the contractor's release discharging the Government from all liabilities, obligations, and claims. The withholding is conditioned on no other factor or event. The contract clause authorizes the withholding "unless otherwise provided in the schedule."

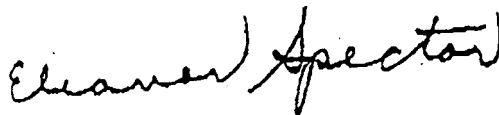
In drafting contracts, contracting officer <sup>6</sup> should not reduce or eliminate the withholding unless the administrative contracting officer is fully satisfied that the contractor's previous performance in providing necessary releases has been adequate. The modification of a contract after award to reduce the Withholding requires exchange of consideration.

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me Inspector General also reported some confusion as to the applicability of the \$50,000 ceiling on the withholding. As noted above, the withholding is linked to the contractor's release. Under the standard operation of the clause, there should be one withholding (not-to-exceed \$50,000) for each release required. For example, for time-and-material orders issued under a basic ordering agreement, there should be one release and one withholding (not-to-exceed \$50,000) per order, since each order is a separate contract. For other types of contracts where each order is settled and closed separately, one release and one withholding (not-to-exceed \$50,000) per order is required. For those contracts for which there will be only one settlement and closing, even if orders have been used for control of work within the contract, only one release and one withholding (not-to-exceed \$60,000) are required.

The Inspector General also reported a widespread failure to document the basis for decisions to reduce withholdings. There is some evidence that this documentation problem is not limited to this particular withholding decision. In all contractual decisions, contracting officers must make appropriate note of the basis for their actions.

Please remind your contracting officers and procurement managers of the need for continued attention to this matter. This area may also be a fruitful subject for your future acquisition management reviews.



Eleanor R. Spector  
Director, Defense Procurement